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SIPDIS

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SUBJECT: SOBER OUTLOOK FOR AUSTRIA'S ECONOMY IN 2009

REF: (A) VIENNA 1287; (B) VIENNA 0945; (C) VIENNA 0621

¶1. SUMMARY: Austria's economy started to weaken in the second quarter in reaction to the international downturn, now reinforced by the current financial crisis. Austria's two leading economic institutes downgraded their 2008 GDP growth forecasts to 2.0%. Austria's economy is still driven by export growth, but at a much lower pace than in past years. Private consumption is providing little stimulus, while manufacturing and investment are very weak. As a result, projections for 2009 growth were cut markedly to only 0.9-1.2%. Economists warned of major downside risks inherent in this projection and that the 2009 GDP growth could be flat. Unemployment will rise to 4.2-4.4% in 2009. CPI inflation will ease from 3.4% in 2008 to 2.2-2.3% in 2009. The 2008 budget deficit is forecast at 0.6% of GDP, but will rise to at least 1.0-1.2% in 2009, because of the weakening economy and new commitments by the outgoing GoA. END SUMMARY.

Marked Slowdown since the Second Quarter

¶2. The Austrian Institute for Economic Research (WIFO) and the Institute for Advanced Studies (IHS) recently presented revised growth projections for 2008 and 2009. Both institutes downgraded their 2008 forecasts by 0.2-0.3 percentage point to 2.0% based on an unexpectedly weak second quarter and no outlook for improvement. The institutes assume the economy will slow further and bottom out towards the end of 2008.

Tepid Growth of Around 1.0% in 2009

¶3. The institutes revised downward significantly their 2009 growth forecast by 0.5-0.7 percentage points (WIFO to 0.9% and IHS to 1.2%). This reflects the impact on the Austrian economy of global weakening, reinforced by the financial crisis. Analysts expect the economy to reach its low point at the turn of 2008/2009. Absent any major stimulus from either exports, investments or private consumption, the economy will remain on a low growth level of only around one percent, at best. Exports will continue to drive growth but at considerably lower rates than in past years due to weakness among major trading partners and Euro appreciation. Investment spending, with its sensitive reaction to atmospherics and expectations, is projected to grow only 0-1.2% in 2009. Private consumption growth remains sluggish at little more than one percent, reflecting a drop in real per capita after-tax net incomes in 2007/2008. The savings rate will remain above 11% of disposable income in both 2008 and 2009.

¶4. Neither WIFO Director Karl Aiginger nor IHS Director Bernhard

Felderer spoke of a recession, but warned that the 2009 projections have major downward risks, which far outweigh chances for an upward revision. Aiginger said odds are that the GDP growth rate will tend towards zero in 2009. While Aiginger pleaded for a government stimulus package as soon as possible ((?)in late 2008 and early 2009) and moving forward some of the planned income tax cut, Felderer saw no need for stimulus as long as growth does not fall below one percent. Both advocated economic policy measures on the EU level.

Assumptions for Growth Forecasts

¶5. The institutes based their revised 2008/2009 forecasts on the following assumptions:

-- U.S. economic growth of 1.7-1.8% in 2008 and 0.9-1.8% in 2009;
-- Euro area growth of 1.2-1.5% in 2008 and 0.7-1.0% in 2009;
-- EU-27 growth of 1.6-1.8% in 2008 and 1.0-1.3% in 2009;
-- German growth of 1.8% in 2008 and 1.0% in 2009;
-- Oil prices of $105-110 per barrel in 2008 and $90-95 in 2009;
and
-- Dollar/Euro exchange rates of 0.67 in 2008 and 0.71 in 2009.

¶6. Aiginger said that the economic weakening -- a spillover from the U.S. -- is hitting Europe harder than the U.S. due to the Fed's active monetary policy, USG fiscal measures to bolster consumption, and the export stimulus from the low dollar exchange rate. In Europe, the crisis will be worse because of the high Euro exchange rate and the absence of coordinated economic policy measures at either the EU or national level, including Austria.

Labor Market Turning Down Again in 2009

¶7. After record employment growth of 2.5% in 2008 and a resulting low unemployment rate of 3.9-4.1%, Austria's labor market in 2009 will reflect the economic weakening. The projected continued modest employment growth of about 0.5% will not match the stronger growth in labor supply, so that the unemployment rate will rise again to 4.2-4.4% in 2009.

Inflation Projected to Ease

¶8. Inflation is no longer a major concern since the forces driving it (fuel/food prices and the emerging markets boom) are weakening. Monthly inflation rates have edged down slightly since July and this trend is expected to last. The institutes revised their projected annual average CPI increase marginally to around 3.4% in 2008 and lowered by 10-40 basis points the projected 2009 annual inflation rate, now expected at 2.2-2.3%. The high 2008 inflation cut into private households' purchasing power, with sluggish private consumption growth. Per capita pre-tax wages should increase 3.0% in 2008 and 3.3% in 2009, but real after-tax incomes, after stagnation in 2007, are forecast to decline 0.8% in 2008 and rise only 0.7% in 2009.

Budget Deficit: Stable in 2008, Rising in 2009
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¶9. The 2008 federal budget benefited from continued high tax revenues during the first half of the year, but Aiginger says the GoA will exhaust these revenues by its measures to compensate price increases (reftel C). None of the windfall revenues were used for reducing the public sector deficit, which the institutes continue to expect at 0.6% of GDP in 2008. Though the 2009 budget is not yet available, the 0.2% of GDP deficit the outgoing GoA submitted to Brussels in November 2007 in its updated 2007-2010 stability program is obsolete because of the weakening economy and the pre-election package (ref A). WIFO and IHS expect a total public sector deficit of at least 1.0-1.2% in 2009. Economists are concerned about this pre-election spending spree: Felderer asked that the new GoA rethink and even reverse some of these measures. The planned income

tax cut of about 1% of GDP, whether in 2010 or moved up to 2009, is not yet included in these deficit figures. Felderer opined that any new government will soon need to have budget consolidation on its agenda.

¶10. Statistical Annex

Austrian Economic Indicators
(percent change from previous year,
unless otherwise stated)

	(all projected)			
	WIFO 2008	IHS 2008	WIFO 2009	IHS 2009
Real terms:				
GDP	2.0	2.0	0.9	1.2
Manufacturing	3.2	n/a	0.5	n/a
Private consumption	1.0	1.1	1.2	1.3
Public consumption	1.0	2.5	1.0	0.3
Investment	2.2	2.6	0.0	1.2
Exports of goods	4.1	4.8	3.1	4.5
Imports of goods	3.8	4.2	2.7	4.4
Nominal Euro billion equivalent:				
GDP	284.2	283.3	293.3	292.9
OTHER INDICES:				
GDP deflator	2.9	2.5	2.2	2.2
Consumer prices	3.4	3.4	2.2	2.3
Unemployment rate	3.9	4.1	4.2	4.4
Current account (in percent of GDP)	2.8	n/a	2.6	n/a
Exchange rate for US$ 1.00 in Euro	0.67	0.67	0.71	0.71

GIRARD-DICARLO